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Chapter 19 The promise of crowdlending in financing the 2030 Agenda.

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Putting it into perspective

"Our innovation is not in financial analysis, even if we do it better than the banks. Our real innovation is in collective intelligence. [...] We have put sustainable development, the future of the human species and real needs back at the heart of the lending decision." [Head of a crowdlending platform]

Crowdlending is an investment tool that appeared in the early 2000s. This tool allows individuals and companies, via an online platform, to finance directly, in the form of remunerated loans and in a traceable way, projects which are presented to them and on which they can interact publicly.

This tool therefore encourages the development of direct financing decided by a crowd of contributors who place their trust in project leaders via an extremely transparent, rapid and cheap online selection and subscription process.

This chapter aims to analyze the potential of this new financing tool to induce the necessary transformation the financial system required in order to achieve the SDGs.

Financing is indeed at the heart of Agenda 2030. It is also an issue that explicitly touches on two SDGs: SDG 8.3 (development of SMEs) and SDG 9.3 (access to financial services for all enterprises).

Crowdfunding is indeed one of the answers identified by the August 2020 United Nations report "Citizen's Money: Harnessing digitalization to finance a sustainable future". It is now a question of truly developing this tool, which aims to put the human being and sustainable development at the heart of the lending relationship.

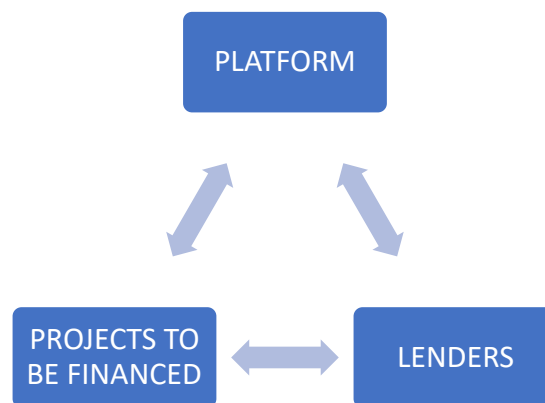
Learning objectives

- Understand the usefulness, potential and limitations of crowdlending in financing and achieving the SDGs of Agenda 2030;
- Understand the similarities, differences and possible partnerships between crowdlending and more traditional financial tools in order to finance the SDGs;
- Analyze and draw lessons from the French case, by comparing and contrasting three crowdlending platform models.

1. Crowdfunding: definition and *raison d'être*

Crowdfunding is a loan underwriting tool operated via an internet platform allowing a group of contributors to collectively choose and lend directly and in a traceable way to identified projects (Figure 1).

Figure 1: Crowdfunding actors



Crowdlending is a sub-category of a larger group, that of crowdfunding, from which it differs by the nature of the financing granted, that of a loan with interest.

Several reasons, linked to the development of entrepreneurship, have contributed to the emergence of crowdlending.

This tool has made it possible to finance development phases or relatively risky types of assets that are not covered by traditional bank financing, such as the creation of a prototype, the financing of an intangible asset, coverage of working capital requirements or a new hire. In the services sector, for example, while it is very difficult to finance the hiring of one's first employee through a bank loan, this is common on crowdlending platforms.

Crowdlending is also characterized by a very high speed of execution which has attracted many entrepreneurs: only a few days can pass between the submission of a financing request and the receipt of funds in the entrepreneur's account.

Crowdlending also allows entrepreneurs to conduct a 'product test' campaign. It allows to create a network of individuals and legal entities willing to support the development of the project (investor-client, investor-supplier, investor-helper).

The personal risks for the entrepreneur are also limited because crowdlending loans are not accompanied by any collateral. On the contrary, the funds raised are considered as personal contributions by the banks and can be used as leverage to take out traditional bank loans.

Beyond these already substantial assets on the scale of an individual entrepreneur, crowdlending has additional singular characteristics that make it a major tool for financing the 2030 Agenda and by putting the human being and sustainable development at the center of finance.

2. Resolving the problem of banks' relationship to risk through principles of trust and collective intelligence.

If sustainable development objectives are under-financed today, this is partly due to the inability of banks to support projects that are, from their point of view, too baroque and exotic, particularly projects that set out specific sustainable development objectives.

Commercial banks have seen their relationship with risk evolve profoundly and be gradually distorted. Originally, commercial banks took their share of the risk of the projects they financed. They had an entrepreneurial, human and partnership approach to the lending relationship. But this approach has disappeared with the phenomenon of bank concentration. The small banks, close to their customers, anchored in their territory, able to collect implicit knowledge about their ecosystems, these proximity banks have disappeared, especially in France.

The bankers of yesteryear, local notables, who were on first-name terms with entrepreneurs in their territories, checked in with every member of their families, knew every accountant in the circle, were invested in chambers of commerce and were literally well established.

These old-fashioned bankers have disappeared, replaced at best by 'business relationship managers' who change every year, and at worst by voice mailboxes that offer a tree of choices, the last option of which is to be put in touch with a human being located on the other side of the world.

This evolution of the banking sector has of course had an impact on the risk profile of banking institutions. Today, banks have adopted a strategy of limiting the risk of default, which consists of granting loans only against guarantees, sureties or collateral that reduce their own risk-taking to a trickle.

As a result, the banks' relationship to risk is short-termist and risk-averse. It is the so called 'belt and braces' policy. Bankers only meet with project leaders between two doors, for about ten minutes. Project leaders are asked to fill in disembodied questionnaires in order to define a pre-existing box into which their project can fit.

Anything that looks new or original, anything that is not perceived as non-risky, is not funded. And this is often the case for projects related to sustainable development. The human encounter between a banker and an entrepreneur, the long-term relationships that used to take years to develop, are no longer even initiated. The relationship with the general interest has also changed. The banks' risk aversion is the same for projects that would serve the general interest as for those that do not have this particular purpose. The lending relationship has become cold and disenchanting.

And that's where crowdlending can come in. Crowdlending can remedy this form of degeneration of the banking profession, and put the human relationship and sustainable development back at the heart of the lending relationship.

Crowdfunding allows a local community of human beings to be publicly mobilized around the financing of a concrete project. As the fundraising process takes place on the Internet, the project owner puts his or her reputation and digital identity at stake in this financing process. The presentation of the project and the answers to questions publicly asked on the forum will remain online for years. Lenders will also be able, after the campaign, to come back to the forum and find out about the progress of the project they have helped to finance. The conditions for creating a real relationship of trust and responsibility between the project owner and the crowd of people who want to support him or her have been met. The human link is direct and full.

Crowdfunding also allows for the emergence of a form of collective intelligence in the evaluation of the project, upstream of its financing.

A manager of a French crowdlending platform explained in 2017, during an interview with the authors of this chapter, that "*out of the 4,000 people who visit the page of a project to be*

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financed, there are usually people who have twenty years of experience in the business, people who have a strong business vision, people who may be very knowledgeable about one or another aspect of the project... In short, the Anglo-Saxons call it collective intelligence. The public interacts in the form of a public forum with the manager. The individual will ask questions and get answers, these answers are public and come in the interest of everyone”.

Crowdfunding also allows for the emergence of a form of collective intelligence downstream from the projects. First of all, it is the creation, throughout the campaign, of a network of supporters able to support the project. Thus, the leader of a French platform explained to the authors of this chapter in 2016 that *"this company, if it had financed itself in a bank, would not have found all this network and it might have failed the year after or in two years. The company gathered contributors, yes, but more importantly, customers, partners, ambassadors for the post-campaign. All of this is to illustrate the fact that there's not just crowdsourcing of projects, there's also the opportunities generated by the network after the funding"*.

But crowdlending is also a collective risk pooling mechanism that effectively makes default painless for lenders. Indeed, the tickets per individual are of the order of 200 euros, and it is the mass of contributors that makes it possible to finance extremely risky projects with large overall amounts. Given that these projects allow lenders to feel useful by investing (because of their objectives, their meaning, the political aim they have), the possibility of losing an investment of 200 euros is accepted in a painless way. The altruistic feeling of participating in a meaningful project may cover the possible loss of a 200-euro ticket for the individual who invested it.

3. Recycling bank money creation into impact investments.

On another level, central banks are now questioning the effectiveness of their traditional intervention tools. Between the creation of bubbles on certain types of assets or the capture of the effects of their policies by intermediaries disconnected from the real economy, the usefulness of central banks' tools is clearly questioned.

Proposals such as helicopter money or the creation of digital currencies by central banks are now explicitly considered. But crowdlending is another tool that would make it possible to recycle money creation towards impact investments. It would indeed be possible to create specific crowdlending platforms dedicated to projects that have an impact on SDGs. A partnership system between banks and platforms could also be deployed.

For example, for one euro lent by the crowd, banks would contribute two euros. Schemes similar to this automatic matching system have been tested, for example on the French platform Unilen. It would thus be possible to direct finance towards impact projects, whether it is voluntary or falls within the framework of binding regulations.

This is precisely one of the perspectives opened up by the August 2020 UN report *"Citizen's Money: Harnessing Digitization to Finance a Sustainable Future"*. This report emphasizes several points in particular:

- *"Digitalization has the potential to enable every nut and bolt of financial processes to be unbundled and commoditized [...] Digitalization enables new business models, such as peer-to-peer lending, crowdfunding platforms. These are not just cheaper ways of doing existing things, they offer new ways of bringing together hitherto fractionalized interests in financing decisions - such as by local communities, young people, parents and other interest-based groups."* (pp. 20 and 22);

- *"Crowdfunding platforms and peer-to-peer lending has opened new avenues for aggregating atomized interests, enabling citizens to overcome trust barriers and free riders to act collectively in financing things they value. Through special-interest platforms, citizens have mobilized and funded each other's sustainable development projects ranging from renewable energy to legal cases to protect the environment and human rights" (p.37).*

This report also presents examples of crowdfunding platforms dedicated to sustainable development such as 'Bettervest', 'Oneplanetcrowd' or 'Abundance' in the UK.

In France, three very different business models have been developed around crowdlending. The study of these models allows us to reflect on the potential of crowdlending in relation to the financing of sustainable development.

4. The French case: three coexisting business models of crowdlending

Table 1 summarizes the main characteristics of the three business models of the crowdlending platforms that have developed in France recently: the 'collective intelligence' model, the 'debt fund' model and the 'marketplace' model.(Table 1). Each of the last three columns of this table is dedicated to one of the three models. The first column lists the criteria that distinguish these models from one another. This table summarizes the remainder analysis presented in this section.

Table 1: Comparison of the three crowdlending models in France

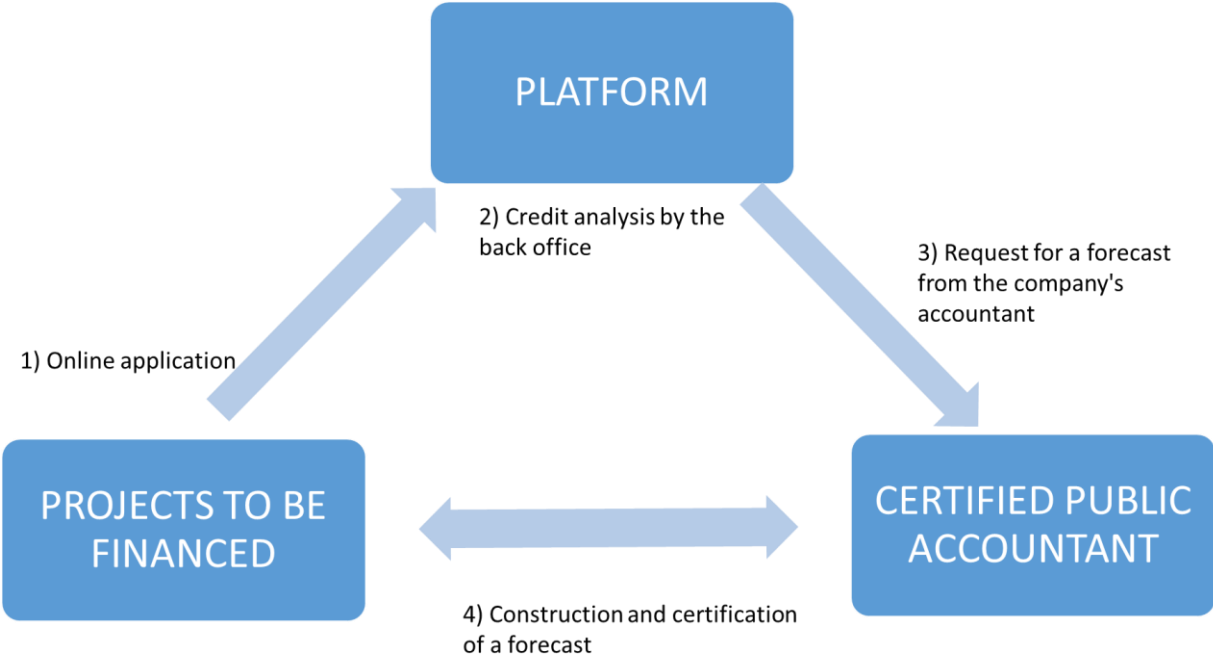
	Collective Intelligence model	Debt Fund Model	Marketplace model
Past experience of the founders	Crowdgiving	Investment funds	Financial marketing
Collective Intelligence Hypothesis	Sustained and integrated	Criticized and opposed	Neutralized
Financial participation of the platform's leaders in the projects	No	Systematic	No
Role of institutional investors	No	Almost hegemonic	Important
Role of scoring algorithms	Low	Low	High
Collateral requirements	No	Total	No

Setting the rate	Through the platform	Through the platform	By the contributors in the framework of a reverse auction procedure
Setting the target amount	Through the platform	Through the platform	Through the platform
Nature of rate by project	Same for all contributors	Same for all contributors	Differences between contributors
Reimbursement by the platform to contributors in case of default	Only in case of fraud	Only in case of fraud	No
View regarding the creation of a secondary market	Against	For	For
Controlling entities of the platform	ACPR	ACPR for the platform, AMF for the securitization funds	ACPR for small projects with individual lenders, AMF for other cases.
Institutional links with banks	Initial link with Orange Bank, then acquired by Banque Postale	Banks present in FCTs (Fonds Communs de Titrisation)	A French public bank is a shareholder of the platform, and there is an agreement with a commercial bank that has the possibility to participate up to 40% on each project

4.1 The *Lendopolis* case: disrupting banking intermediation by organizing the expression of collective intelligence

The specificity of this first business model (Figures 2 and 3) lies in the central place given to the crowd and the particular, the care taken in organizing the expression of collective intelligence. Here, contributors are exclusively individuals with an average ticket of 160 euros per project. For each project proposed for financing, the crowd of individuals has access to a description of the project, a three-year forecast certified by a chartered accountant, and a public forum where they can interact with the project owner in complete transparency.

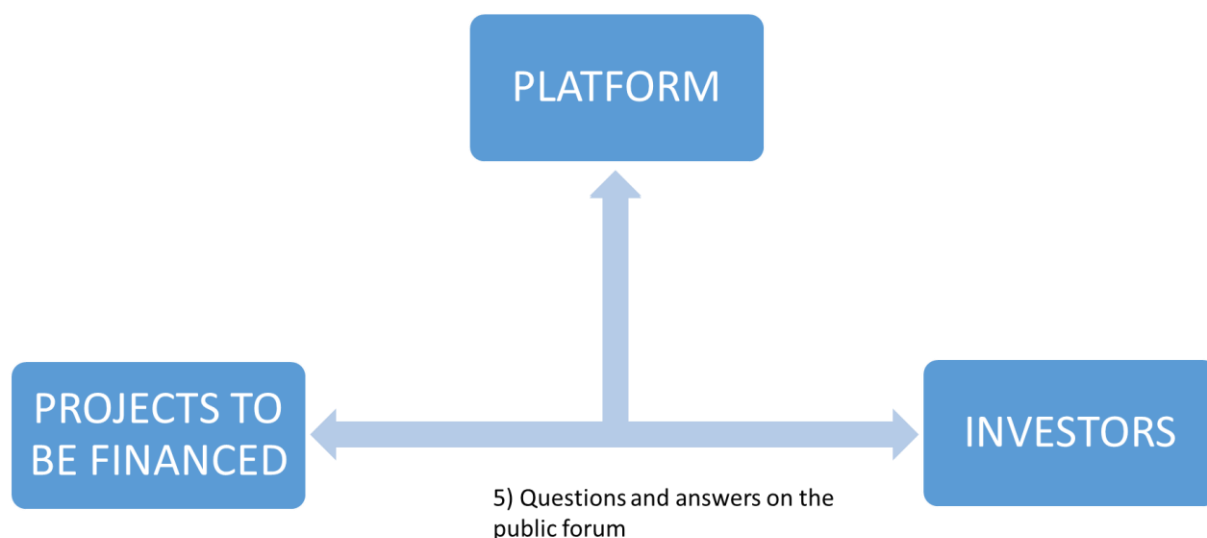
Figure 2: Diagram of the Lendopolis model - phase 1



"In itself we have a somewhat innovative approach compared to traditional finance in the sense that we have developed, a partnership with the Superior Council of the Order of Chartered Accountants, to not only work on the last two tax returns of the company but also on a estimate of the current year and two years of forecasting that are attested" [Lendopolis, Risk Director]

Above all, this crowd has a relatively long and protected period of interaction with the project leader compared to the other two models discussed below. The crowd also has a real capacity to decide whether or not to grant the requested funding. Indeed, if the amount initially set as a fundraising goal is not reached due to a lack of contributors, the project owner does not receive any funds.

Figure 3: Diagram of the Lendopolis model - phase 2



"If we don't give them [the crowd] information [...], there is no collective intelligence. In the same way that if we don't give the public the means to express themselves on the company via the forum, if we don't give them the means to stop the collection if a negative element appears, we no longer work with collective intelligence." [Lendopolis, CFO]

The platform's role is to accept (or reject) the projects that are submitted online, to set the amount of the loan and the interest rate paid to individuals, and above all to organize the expression of collective intelligence. After the collection, if the project owner defaults, the platform does not intervene unless this default is linked to a scam that it would not have detected. Apart from this specific case, the default leads to a loss borne by the participating individuals. This remains relatively painless given the limited amount of average tickets per individual, and the maximum legal threshold of 2,000 euros per project and per individual.

This business model is driven by people who have no previous financial experience and who are philosophically driven by what they themselves call their 'faith in collective intelligence', coupled with a desire to put the human being and simplicity back at the heart of finance.

"There are people like [the founder of Lendopolis], who believe deeply in collective intelligence, and for whom it is almost a philosophical act to crowdfund" [Ministerial advisor] These leaders are absolutely against any idea of creating a second market for debt issued on platforms. They believe that too much complexity in financial vehicles is not healthy because it leads to the masking of risks and alienates citizens from finance. These leaders also consider themselves to be the only 'chemically pure' representatives of crowdlending, and are initially opposed to any assimilation to the other two models that we will now describe.

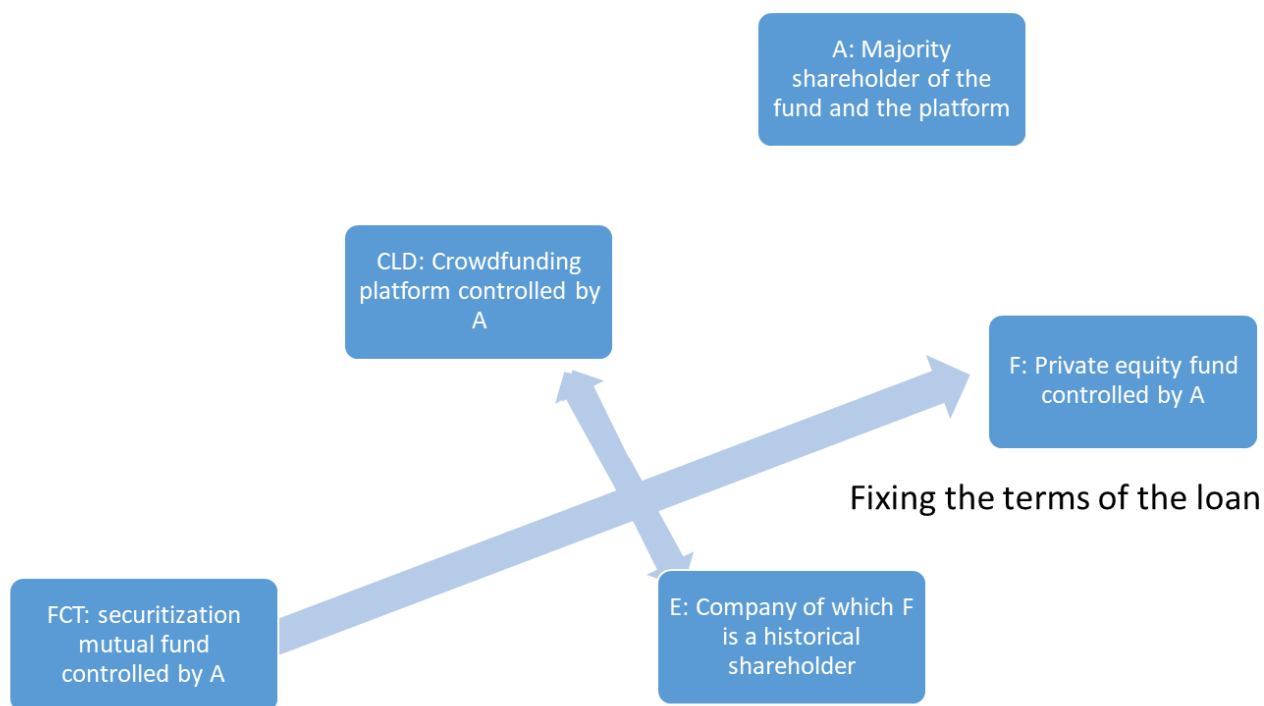
4.2 The Lendix case: extending traditional finance by combining debt funds with an investment fund

Lendix's business model (Figure 4) is organized around a debt fund (i.e. a fund that brings together institutional investors who take on debt to invest in loans). Most of the companies financed have had, or still have, an investment fund, *123 Venture*, as a shareholder for about ten years, whose founder is also the founder of Lendix. The teams working on the crowdlending platform are themselves, for the most part, staff of this investment fund.

"The platform relied on the know-how and expertise that had been developed by 123 Venture" [Lendix, Board member].

The platform is therefore particularly familiar with the companies financed, having followed them, via this investment fund, as a shareholder for many years. As a result, the intelligence of the crowd does not appear to be useful, and the credit analysis is not innovative compared to 'traditional finance'. The analysis is performed by the platform's analysts.

Figure 4: Diagram of the Lendix model



"On credit analysis, we do what all banks do, i.e. we analyze the company's figures, its income statement. I'm not telling you that. We make a note of it". [Lendix, Internal Control Manager]

The share of the crowd in the financing of the project is also very limited. Thus, in this business model, only 10% of the amounts lent come from individual contributors. The remaining 90% is matched by institutional investors (banks, insurers and family offices) grouped together in several securitization mutual funds (FCT) created by Lendix's directors.

These institutional investors subscribe to loans under the same interest rate and maturity conditions as the individuals investing on the platform, but without any limit on the amount. As rates are very high on crowdlending platforms, this system allows institutional investors to achieve rate of returns that they would not be able to achieve by investing directly without taking a significant reputational risk. The interest rate and the overall amount of the loan are set by the platform. As soon as a project is put online, it is certain to be financed: even if no individual agrees to contribute, the securitization pool will match the entire amount requested.

"It's almost an extension of the bank more than a new philosophy since they've created a securitization fund that allows them to do all the financing once they've qualified the thing, and mix the institutional people in the securitization fund and the crowd." [Departmental Advisor]

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The investment decision is therefore made by the platform, not by the crowd. Moreover, the follow-up of the companies after the loan campaign is more advanced than in the previous model, in particular because of the intervention of the institutional investors in this follow-up, who have significant human resources. Finally, as in the previous business model, the platform only reimburses contributors who have suffered a default in the event of a scam that it was unable to detect.

Finally, the managers of this platform have a very long experience in financial analysis. They grant, in a personal capacity, and in an automatic way, a loan to each project presented on the platform, in order to show an alignment of interest between the contributors and the platform.

4.3 The Unilend case: towards a ‘Euronext’ market place for private debt

In the ‘market place’ business model (Figure 5), the ambition is to create a ‘private debt Euronext’, i.e. a place for continuous issuance and trading of private debt. This is a model for extending disintermediated finance:

"Today, the main problem with financial markets is that they are only accessible to very large companies that have the capacity to issue financial instruments, to make very important financial communications and which, through the size of the underlying assets they issue, provide liquidity to the market and can therefore be organized on regulated markets, with depth, etc., which does not prevent liquidity crises from occurring. What we are in the process of creating with a platform like Unilend is basically a marketplace, that's how we see ourselves. Our ambition is to create the equivalent of Euronext for private debt." [Unilend, Founder]

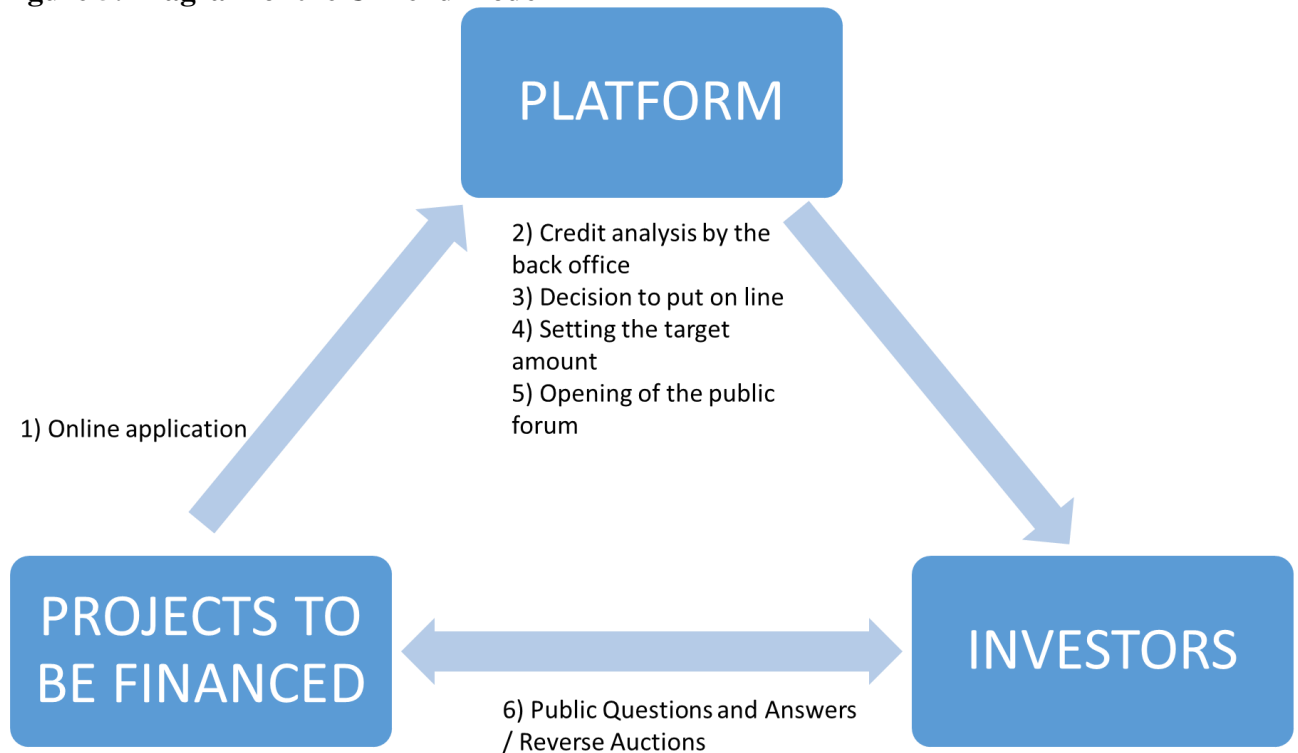
It should be noted first of all that this ambition has an important limitation. If Unilend can be likened to a primary market for private debt issuance, this platform does not yet have the legal possibility of creating a secondary market.

However, this platform is faster than the two other platforms presented above, thanks to the use of scoring algorithms. The selection of projects is therefore much more automated than in the two previous examples.

"We have interfaced with almost thirty databases to enable us, from the government identification number for companies, to have a lot of information on the company, from its payment behaviour, its balance sheet, its history, its privileges, in short a whole bunch of things... precisely to enable us very quickly to reject a lot of files in an efficient way without mobilizing people at home" [Unilend, Founder].

Unlike the two previous business models, the loan rate is not fixed by the platform and is not unique to a given project. Indeed, the platform only gives a risk rating per project, and each contributor indicates for which rate and for which amount he is willing to lend money to the project. The contributors with the lowest rates are served first until the full amount requested by the project owner is reached. It is therefore a reverse auction mechanism that allows different rates to be served between contributors and to obtain the lowest possible weighted rate for the project owner.

Figure 5: Diagram of the Unilend model



This business model also features an ‘autolend’ module that automates loan subscriptions. In this module, contributors can register automatic orders: for each project with a given risk rating, in a given sector, ‘autolend’ will automatically and instantly participate in reverse auctions, as soon as they are opened, for an amount and at a rate defined in advance.

Thanks to this module, fundraising campaigns often last only a few hundredths of a second between a project being put online and the end of the fundraising campaign. This very short time, however, makes it impossible for lenders to interact with the project owner, a necessary condition for the expression of collective intelligence.

This business model also allows legal entities to contribute financially to projects, but within a limit of around 40% of the amounts financed. It has the particularity of having a public development bank, the *Banque Publique d'Investissement* in its capital as well as a partnership with *Groupama Banque* which can finance up to 40% of each project. The director of the platform’s first career was in marketing in financial institutions.

5. Towards embedding crowdlending in traditional finance in order to achieve the goals of the 2030 Agenda

After analyzing these three models, we can now turn to the question of whether crowdlending in France has a real potential that could lead to better financing of the 2030 Agenda's SDGs. Looking at the volumes involved, one thing is clear: crowdlending platforms alone are not large enough to have a real impact. It is true that we have not yet seen a tidal wave of crowdlending that would replace traditional financing the banks. The amounts collected in the form of crowdfunding (Table 2) have continued to increase from year to year, but are still too low to really close the financing gap for the SDGs.

Table 2: Amounts raised through crowdfunding in France in euros

2015	2016	2017	2018	2019	2020
167 million	234 million	336 million	402 million	629 million	1,020 million

(these figures come from the barometer published by Financement Participatif France in 2020)

To quote a representative of the French Banking Federation whom we interviewed:

"When you look at the amounts [on crowdlending platforms], today we are at less than 300 million [in loans]. So, if they double that every year for 10 years, maybe... Last year, French banks produced 240 BILLION euros in new loans!" [FBF]

Moreover, the only model that has survived and even developed throughout Europe is that of Lendix, which is embedded in the traditional players.

It is this model that has the particularity of being structured in such a way as to benefit from the technical expertise of former employees of an investment fund as well as from the long-term relationships that these employees have maintained with the companies applying for financing. The Lendix model is inclusive in that it allows traditional financial players, notably banks, insurance companies and asset managers, to join together in a common securitization fund and to provide an average of 90% of the financing for the projects put online on the crowdlending platform.

This way of embedding crowdlending with traditional financial actors (Figure 6) seems to be able to create a leverage effect for the benefit of projects whose ambition is to reach the SDGs. Banks thus see crowdlending as an opportunity to leverage traditional loans and to lend to their clients without abiding the Basel prudential framework.

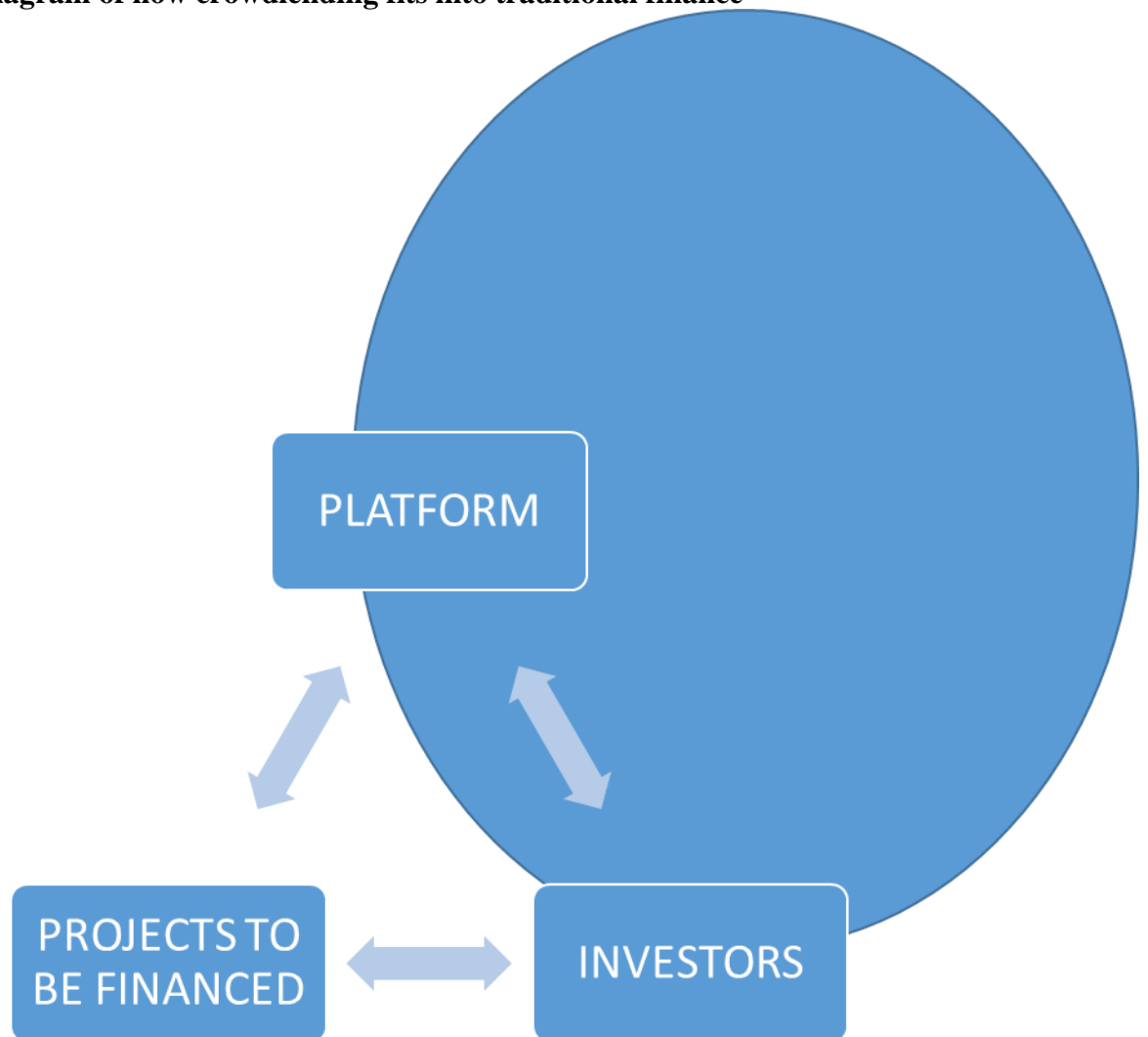
The use of crowdlending in the context of a hybrid bank/platform financing provides banks with the assurance of mutualizing of risk, and reduces the cost of a default on the total amount at stake (or on a part of it).

In this context, banks will be able to use crowdlending as a new default risk management tool. They will be able to finance non-collateralizable risks at higher interest rates than those they usually charge. This will in turn enable them to better contribute to the financing of the actions needed to achieve SDGs.

This crowdlending/banking integration would ideally allow banks to reconnect with local communities that they had previously abandoned, by multiplying regional hybrid financing initiatives. These campaigns could also have a positive impact on the image of banks in the territories. But perhaps more fundamentally:

"As an old-fashioned, almost retired banker, I can say that investing in this platform has allowed us to reconnect with an aspect of our business that we had recently neglected. I'm talking about our impact in the regions. That is, our human, social and community-building role. Our sustainable action to support meaningful things and unite communities. We're not just machines that check off boxes in the Basel regulations. We are here to contribute to meaningful projects, useful projects that are worth taking risks, even if it means losing sometimes. It's not marketing. It shouldn't be. It's a return to the true meaning of the lending relationship." [Bank]

Figure 6: Diagram of how crowdlending fits into traditional finance



It thus seems that the following vision of a representative of the banking institutions' union might be taking shape:

"I see this world converging towards the banks. I'd be in a bank's marketing department, and I'd be looking to integrate this crowdlending function. There are already partnerships, equity investments, that also allow (this integration) because you have to pass a profitability or development threshold (...)" [FBF]

Summary and conclusion

- Crowdlending is a credible tool to contribute to putting human beings and sustainable development back at the heart of the credit relationship.
- Crowdfunding brings new elements compared to traditional finance: digitalization, speed of execution, absence of collateral, level of rates, traceability, pre-eminence of meaning and locality, mutualization of risk between small lenders.

- A form of collective intelligence can emerge on crowdlending platforms. It is the crowd that is co-responsible for investment decisions. It has a long period of interaction with the project owner and robust information to exercise this decision-making power.
- Because of its intrinsic characteristics and its various models, which are still in the process of being tested, crowdlending seems to offer a possibility of embedding itself in traditional finance in order to partially convert the latter to the financing of the SDGs.
- Crowdfunding can help to nuance the objectives of financialization by making traditional players aware of the principles of trust and collective intelligence.
- Crowdfunding can help recycle money creation towards impact investments in line with the 2030 Agenda.
- Through the development of crowdlending, we are witnessing the gradual empowerment of a whole series of players who are acquiring new financial capacities and opening up to new financing objectives.

Activities

Questions for discussion

1. Is crowdlending a way to democratize finance?
2. Which of the three models described in this chapter do you think has the most future?
3. Can a crowd of anonymous people bring something useful and complementary to financial experts?
4. Is the concept of collective intelligence credible in finance?
5. Is it utopian to think about the SDGs without thinking about how they will be financed?
6. Are banks doomed to disappear?
7. Should individuals be prohibited from taking financial risks?
8. How to limit the consequences of a default on a debt?
9. When a project is already financed, is it still potentially useful to use crowdlending?
10. Can banks partner with crowdlending platforms?

Mini-case : The Lendosphere platform

Visit Lendosphere (www.lendosphere.com), a crowdlending platform specialized in financing sustainable development projects. Browse through the projects already financed and the projects currently being financed. Also read the "FAQ" and the statistics of the platform.

Then answer the following questions:

1. To which SDGs do the projects funded on the platform contribute?
2. How many projects have been funded on this platform? For what total amount?
3. How does the platform pay for itself?
4. What are the interest rate levels applied on the platform?
5. What is the role of collective intelligence on the platform?
6. Who regulates this platform?
7. Does this platform bring anything useful or new compared to a bank?

Mini-case : Imagine a project related to an SDG and for which you need to find 500,000 euros. Prepare a word document of presentation of the project to the private individuals who lend on the platform Lendosphere.

To go further

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